

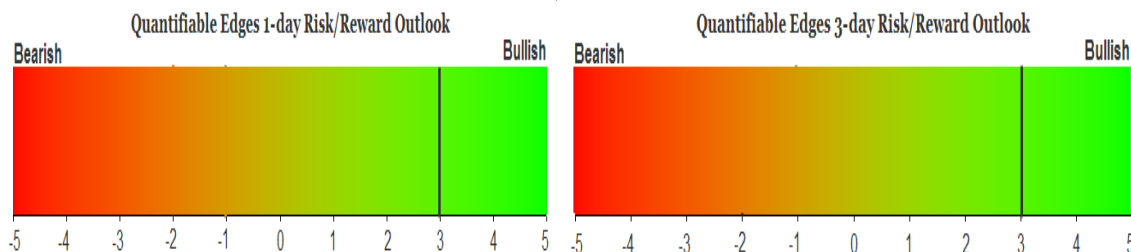
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 18, 2009

Volume 2 Issue 244

Market Overview



Tonight's Research Points

- High volume selloff may contain slight bearish edge for the next few days.
- Drops > 1% with 3:2 breadth have historically been followed by a move higher.
- Closes in the bottom 10% of the daily range have led to consistent bounces since the March bottom.
- The unfilled gap and poor close provide a much better upside edge when the SPX is gapping down from under its 10ma.
- Aggregator System changed to long at the close today..

Short-term Outlook – updated 12/18

The Bottom Line

Despite only being down 1 day there is ample evidence that a bounce is likely. I'm looking to take advantage off this dip. Not going to overdo it immediately though.

Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> or Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 18, 2009	SPX closed in bottom 10% of daily range	1-3 days	Bullish	2.70%
December 18, 2009	SPX down 1% & Declines 2x Advancers	1-9 days	Bullish	3.40%
December 14, 2009	December Op-Ex Week Bullish	1-5 days	Bullish	2.00%
Active - Long Term				
December 7, 2009	Nasdaq Leading S&P	int. term	Bullish	
December 2, 2009	VIX:VXV crosses below 0.9	2-5 months	Bearish	
Dropped Tonight				
December 15, 2009	SPX breakout to 50-high	1-3 days	Bullish	1.20%

If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

The Evidence

After gapping down quite a bit on Thursday the market never made much of an attempt to rally and fill the gap. It continued lower for much of the day and finished near its lows. The S&P, Nasdaq, and Russell all closed down over 1%. Breadth was strongly negative. The NYSE Up Issues % was 28% and the Up Volume % came in at 13%. Total volume was very high.

Lots to look at tonight so let's get to it.

I'll start off with the one bearish study that was appearing in the Quantifinder tonight. It was last published in the 9/2/09 Subscriber Letter.

NYSE volume is the highest in 20 days. SPX drops 1% but does not make a 10-day low. Buy on close. Sell X days later. \$100k/trade. 1960-present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-6,782.93	19	8	11	42.11	2,177.15	-2,200.01	0.99	0.72	-357.00
4	-5,593.69	19	6	13	31.58	3,058.12	-1,841.72	1.66	0.77	-294.40
3	-1,581.27	19	7	12	36.84	2,301.40	-1,474.26	1.56	0.91	-83.22
2	-5,480.57	19	9	10	47.37	1,690.84	-2,069.82	0.82	0.74	-288.45
1	3,553.32	19	8	11	42.11	1,603.84	-843.40	1.90	1.38	187.02

What once appeared as a decent downside edge is now looking more questionable. I'm not going to include this in the Aggregator tonight. I will continue to keep an eye on it though.

This next study is one that we've seen several times. It looks at broad, strong selloffs. It last appeared in the December 9, 2009 Letter (stats not updated).

SPX drops at least 1% and delciners more than double advancers. Buy SPX on close. Sell X days later. \$100k/trade. 10/20/87 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	236,001.75	241	164	77	68.05	2,729.63	-2,748.79	0.99	2.12	979.26
9	257,847.48	246	170	76	69.11	2,673.00	-2,586.35	1.03	2.31	1,048.16
8	218,319.97	261	170	90	65.13	2,627.02	-2,536.37	1.04	1.96	836.47
7	230,029.57	281	176	105	62.63	2,616.24	-2,194.57	1.19	2.00	818.61
6	210,273.32	297	185	112	62.29	2,470.91	-2,203.98	1.12	1.85	707.99
5	189,511.28	326	195	131	59.82	2,295.90	-1,970.91	1.16	1.73	581.32
4	135,930.53	348	201	147	57.76	2,043.33	-1,869.24	1.09	1.49	390.60
3	160,626.17	380	236	144	62.11	1,756.73	-1,763.63	1.00	1.63	422.70
2	152,395.20	433	244	189	56.35	1,691.64	-1,377.59	1.23	1.59	351.95
1	112,434.84	485	290	195	59.79	1,124.34	-1,095.51	1.03	1.53	231.82

This study was actually getting ready to expire in the next day or two. I have reset it and it is included now at the top of the Active Studies list.

Another Quantifinder study looked at closes in the bottom 10% of the daily range since the March bottom. I've updated that one below:

SPX closes in bottom 10% of daily range. Buy on close. Sell X days later. \$100k/trade. 3/6/09 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
3	33,332.99	20	15	5	75.00	2,606.18	-1,151.94	2.26	6.79	1,666.65
2	18,055.69	23	15	8	65.22	1,936.15	-1,373.33	1.41	2.64	785.03
1	15,001.77	23	15	8	65.22	1,274.96	-515.33	2.47	4.64	652.25

Of the 23 instances, only 2 (5/11/09 & 10/26/09) failed to close higher than the entryprice at some point in the next 3 days.

Of the 23 instances, only 1 (5/20/09) failed to trade above the closing price at some point the next day..

This study is what I sometimes refer to as an “environmental edge”. I believe a good portion of its recent success is due to the strongly bullish environment. Environmental edges have their place and I like to pay attention to them for as long as they appear to be working. I don't expect it to last forever. It may stop working prior to a major shift in the market – perhaps providing a clue to a change in the environment. Another example of an environmental edge that served us well while it worked was the “2 Days in chop” strategies.

Thursday's unfilled gap down and poor close is something else I looked at in the context of the longer-term uptrend.

SPY gaps down and doesn't fill. It closes in the bottom 25% of its daily range and above the 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	69,144.61	82	51	31	62.20	2,368.86	-1,666.69	1.42	2.34	843.23
9	77,318.79	86	57	29	66.28	2,224.20	-1,705.55	1.30	2.56	899.06
8	76,310.25	89	52	37	58.43	2,533.25	-1,497.81	1.69	2.38	857.42
7	77,838.66	92	59	33	64.13	2,235.05	-1,637.25	1.37	2.44	846.07
6	72,480.78	94	56	38	59.57	2,208.94	-1,347.89	1.64	2.42	771.07
5	55,108.55	94	56	38	59.57	1,902.02	-1,352.76	1.41	2.07	586.26
4	39,920.63	97	56	41	57.73	1,665.06	-1,300.55	1.28	1.75	411.55
3	27,288.80	100	54	45	54.00	1,491.33	-1,183.18	1.26	1.51	272.89
2	26,562.99	102	55	45	53.92	1,283.27	-978.15	1.31	1.60	260.42
1	17,981.66	103	59	43	57.28	799.68	-679.06	1.18	1.62	174.58

At first blush the results appear to provide a decent upside edge. But if I add another filter you'll see that the short-term market position matters quite a lot. At Wednesday's close, prior to the gap down, the market was trading in the upper portion of its range (above the 10ma). Below are the results broken out by times the setup occurred above and below the 10ma.

SPY gaps down and doesn't fill. It closes in the bottom 25% of its daily range and above the 200ma. Yesterday it closed above the 10ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	30,296.68	67	39	28	58.21	2,090.61	-1,829.89	1.14	1.59	452.19
9	34,557.00	68	43	25	63.24	1,988.35	-2,037.68	0.96	1.68	508.19
8	33,556.94	71	39	32	54.93	2,169.79	-1,595.77	1.36	1.66	472.63
7	40,600.85	73	45	28	61.64	1,904.72	-1,611.13	1.18	1.90	556.18
6	37,505.23	74	43	31	58.11	1,819.96	-1,314.61	1.38	1.92	506.83
5	25,893.77	74	42	32	56.76	1,620.04	-1,317.12	1.23	1.61	349.92
4	13,776.25	76	40	36	52.63	1,514.86	-1,300.51	1.16	1.29	181.27
3	3,434.38	77	37	39	48.05	1,315.88	-1,160.34	1.13	1.08	44.60
2	3,936.17	79	36	41	45.57	1,155.84	-918.88	1.26	1.10	49.82
1	-830.02	80	41	38	51.25	619.86	-690.64	0.90	0.97	-10.38

Not much better than market drift here.

SPY gaps down and doesn't fill. It closes in the bottom 25% of its daily range and above the 200ma. Yesterday it closed below the 10ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	45,589.47	22	17	5	77.27	2,920.86	-813.04	3.59	12.21	2,072.25
9	44,824.09	22	17	5	77.27	2,828.33	-651.50	4.34	14.76	2,037.46
8	46,280.78	22	17	5	77.27	3,167.88	-1,514.63	2.09	7.11	2,103.67
7	41,428.99	22	17	5	77.27	2,961.56	-1,783.51	1.66	5.65	1,883.14
6	35,948.40	22	14	8	63.64	3,344.24	-1,358.88	2.46	4.31	1,634.02
5	28,242.48	22	14	8	63.64	2,747.97	-1,278.63	2.15	3.76	1,283.75
4	24,712.73	22	16	6	72.73	2,040.54	-1,322.64	1.54	4.11	1,123.31
3	23,854.42	23	17	6	73.91	1,873.19	-1,331.64	1.41	3.99	1,037.15
2	22,626.82	23	19	4	82.61	1,524.71	-1,585.67	0.96	4.57	983.77
1	18,811.68	23	18	5	78.26	1,209.28	-591.09	2.05	7.37	817.90

When the gap down and weak close happened after the market was already selling off the edge appears to be immediate and large.

So in the current case the unfilled gap and poor close don't appear to be providing much of an edge.

I have updated the [Aggregator](#) chart below.



Both lines spiked up quite a bit today. The green Aggregator line was helped greatly by tonight's studies. Net expectations over the next 3 days have increased substantially. Meanwhile the SPX has now strongly underperformed expectations over the last 3 days which has caused the large move up in the black Differential line. Oversold versus expectations and positive expectations over the next few days have historically been a bullish combination. The Aggregator System went long at Thursday's close based on this.

Based on the current numbers it would take quite a rally on Friday to signal an exit for the Aggregator System. For the Differential line to flip negative the SPX would need to close around 1,109 or higher.

Based on all of the above I'm bullish for now and will look to take advantage of a possible bounce. We could have a bit farther to drop though, as it has only been 1 down day at this point and we aren't yet even approaching the bottom of the recent range.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/14 –somewhat bullish

With the market still stuck in the range of the last several weeks, not much has happened to change my outlook. I can't imagine turning bearish unless there is a breakdown in price.

I've been watching breadth for a while now as both the Advance/Decline and the Net New High % has lagged over the last couple of months. There's been some improvement in the advance/decline line and it is just inches away from making new highs and

confirming the rally. The new highs has a ways to go so even if the advance/decline breaks out here we'll need to keep an eye on new highs.

The Nasdaq/S&P 500 Relative strength indicator still favors the Nasdaq though the difference couldn't be smaller. If the S&P outperforms this week then it will surely take the lead back. You'll recall that the Nasdaq leading has been a much more favorable relationship since the inception of the Nasdaq. This was shown in detail in the blog in earlier this here. [Click here to view that study.](#)

The dollar rallied a bit this week and squarely broke through its 50-day ma. Despite this the S&P managed to close the week slightly higher. The dollar and S&P have had a strong inverse relationship since 2008. I ran a test back to December of 2007 to see how the S&P had performed other times when it managed to rise in spite of a dollar rally over a 5-day period. What I found was basically meaningless. During the bear market results showed downside over the next 1-2 weeks. During the recent rally the S&P followed such instances with more upside. You could test most anything over the same period and get similar results, so I'm not reading anything into it.

If the dollar continues to rise and the S&P can manage to hold up well I would interpret that as bullish.

In summary, price action and leadership remain bullish. Volume action could use some improvement. Breadth is close to ending its divergence. The S&P is holding up well despite a brief rally in the dollar and we are entering one of the most bullish times of the year from a seasonality standpoint. I see no convincing evidence to flip me bearish yet.

Catapult and Capitulative Breadth Statistics

(Catapult Presentation Part 1) (Catapult Presentation Part 2)

Open Catapult Triggers

none

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 0

Additional New Trade Ideas

A full listing of system triggers can be found at the [system triggers page](#) each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.

SPY – buy ¼ index position @ \$110.18 limit. Looking to get long based on the short-term outlook and Aggregator configuration.

IWM - buy ¼ index position @ \$60.62 limit. IWM has a strong seasonal advantage over SPY thru the beginning of 2010. I'll also look to allocate some capital here.

Active Trades Table

None

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2009 Hanna Capital Management, LLC.